IN THE

Supreme Court of the United States

October Term, 1977

No. 77-99

UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, *Petitioner,*

v.

BEAR, STEARNS & CO. et al., *Respondents.*

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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INDEX

APPENDIX A

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HOWARD K. PHILLIPS, Clerk, United States Court of Appeals Tenth Circuit

PUBLISH

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE,

Plaintiff-Appellant,

v.

BEAR, STEARNS & CO., et al.,

Defendants-Appellees.

Nos. 75-1854, 75-1855, 75-1856, 75-1858, 75-1860, 75-1861, 75-1862 and 76-1330

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH
(D.C. Nos. NC-74-38 through NC-74-40, NC-74-42, NC-74-44 through NC-74-46 and NC-75-58)

David L. Wilkinson, Special Assistant Attorney General (Vernon B. Romney, Attorney General, was with him on the brief) for Plaintiff-Appellant.

Harold G. Christensen, Parker M. Nielson and Keith E. Taylor (Daniel M. Allred, Krege B. Christensen, Parsons, Behle & Latimer; Dawson, Nagel, Sherman & Howard; Worsley, Snow & Christensen; R. Brent Stephens, Craig G. Cook and Alan E. Walcher were with them on the briefs) for Defendants-Appellees.

Before McWILLIAMS, BREITENSTEIN and BARRETT, Circuit Judges.

BREITENSTEIN, Circuit Judge.

These eight companioned appeals are from judgments dismissing actions brought by plaintiff-appellant, Utah State University, against various brokers to recover losses sustained in securities transactions. The claims are based on alleged violations of certain statutes, administrative regulations, and rules of private organizations of securities dealers. We affirm.

Utah State University of Agriculture and Applied Science, USU, is a corporation existing under the constitution of the State of Utah and operates at Logan, Utah, as a land grant university. Defendants are all brokerage firms organized under the laws of various states other than Utah. Each defendant is a member of the New York Stock Exchange, NYSE, the American Stock Exchange, AMEX, and the National Association of Security Dealers, NASD. Jurisdiction is based on § 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa.

In furtherance of its securities investment program, the governing body of USU on January 20, 1972, adopted a resolution which said:

> (1) USU "is authorized and empowered to open and maintain an account with any broker" who is a member of a major security exchange or of NASD.
>
> (2) The authorization covers "the purchase, trade and sale, long or short, [of] * * * stocks, bonds and securities of every nature on margin or otherwise * * *."
>
> (3) Two named officers, Broadbent and Catron, have power to act under the resolution for USU.
>
> (4) "[T]his resolution shall be and remain in full force and effect until written notice of the revocation hereof shall be delivered to the brokers."

Between February, 1972, and March, 1973, Catron

opened accounts with numerous brokerage firms and purchased millions of dollars worth of securities. Catron, a well-educated man with business and accounting experience, had been a licensed securities salesman. He became the Controller of USU in July, 1970.

In the Spring of 1972, the Utah State Auditor's Office notified Catron that later in the year an audit would be made of the USU investment program. To improve the program's cash flow picture, Catron engaged in a series of transactions in which he sold stock through one broker and immediately repurchased the same stock utilizing another broker. By this operation he received immediate payment for the stock sold and did not have to pay for the stock bought until its delivery.

In December, 1972, an independent auditing firm employed by USU questioned the legality of the USU stock purchase program. In the same month local newspapers reported the belief of an assistant attorney general of Utah that the USU stock purchases were illegal. On December 4, 1972, USU instructed Catron to stop purchasing securities on its behalf. Catron did not stop the USU security transactions until March, 1973, when USU sent to each brokerage firm a written revocation of Catron's authority. On December 23, 1975, the Supreme Court of Utah held that USU did not have the power to purchase common stock with its public funds. See *First Equity Corporation of Florida v. Utah State University*, Utah, 544 P.2d 887.

In each of the eight appeals before us, USU is the plaintiff-appellant. The following list shows the defendant-appellee in each case:

No. 75-1854 — Bear, Stearns & Co.

No. 75-1855 — Blyth Eastman Dillon & Co.

No. 75-1856 — Bosworth, Sullivan & Company

No. 75-1858 — Hornblower & Weeks — Hemphill, Noyes, Inc.

No. 75-1860 — Shearson, Hammil & Co.

No. 75-1861 — Sutro & Co.

Nos. 75-1862 — Merrill Lynch, Pierce, Fenner &
76-1330 Smith, Inc.

USU sued the brokers to recover its losses on stocks purchased and sold and to recover the commissions paid to brokers on all stock transactions regardless of whether USU received a loss or gain. The complaint asserts federal law claims which may be grouped in three categories:

1 — Violations of fair practice and suitability rules of NYSE, AMEX, and NASD.

2 — Violations of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and of Rule 10b-5, 17 C.F.R. § 24.10b-5, promulgated thereunder.

3 — Violations of Federal Reserve System Regulation T, 12 C.F.R. Part 220, promulgated pursuant to 15 U.S.C. § 78g(a)

The complaints also allege various pendent claims under state laws.

In the *Sutro* case no Regulation T claim is presented. The two appeals relating to *Merrill Lynch* will be discussed separately. All defendants except Merrill Lynch filed motions to dismiss the pertinent complaint.

By order, the court allowed the parties "to file affidavits and other supporting material" so that the motions to dismiss could be considered as motions for summary judgment under Rule 12(b), F.R.Civ.P. Many affidavits were filed on each side. The deposition of Catron was

presented. The court dismissed the counts based on the NASD, NYSE, and AMEX rules for failure to state a claim in that violations of exchange and association rules do not give rise to a private cause of action. With regard to the Rule 10b-5 claims the court held that violations of the NYSE, AMEX, and NASD suitability rules did not give rise to a Rule 10b-5 claim and hence, the complaint did not state a cause of action under Rule 10b-5.

As to the claims based on Regulation T, the court held that the regulation did not give rise to a private cause of action and hence failed to state a claim. The court also held that summary judgment was proper on the Regulation T claims because USU was *in pari delicto*. On the pendent claims, the court, in dismissing, noted the pendency of state court actions involving those claims. No questions are raised on these appeals regarding the dismissals of the pendent claims.

The NASD, NYSE, and AMEX Rules.

Article III, § 1, of the NASD Rules of Fair Practice requires a member to "observe high standards of commercial honor and just and equitable principles of trade." Section 2 of the same Article requires a member in recommending the purchase of a security to a customer to have reasonable grounds for believing that the security is suitable for the particular customer. This proscription is often called the "Suitability Rule."

NYSE Rule 405, called the Know-Your-Customer Rule, and the similar AMEX Rule 411 require that a member use "due diligence to learn the essential facts relative to every customer, order" or account.

The Securities Exhange Act of 1934 requires the registration of national securities associations and exchanges.

The rules of these self-regulatory bodies must be approved by the Securities and Exchange Commission, SEC. See 15 U.S.C. § 78o-3b and § 78f(b). The areas and concerns which the rules must cover are statutorily imposed. *Ibid.* SEC must approve any changes in the rules. 15 U.S.C. § 78s(b). SEC can "abrogate, add to and delete from" any of the self-regulatory rules in order to further the purposes of the Act. 15 U.S.C. § 78s(c). Brokers who are not members of NASD have similar rules imposed on them by SEC regulation. For example, forms of NASD's Rules of Fair Practice, Art III, §§ 1 and 2 which are involved in these appeals, are imposed on non-members by 17 C.F.R. §§ 240.15b10-2 and 240.15b10-3.

Colonial Realty Corporation v. Bache & Co., 2 Cir., 358 F.2d 178, *cert. denied* 385 U.S. 817, rejected an implied cause of private action for violation of Art. III, § 1, of the NASD rules. The court recognized that the Securities Exchange Act of 1934 did not specifically authorize actions for violation of private association rules. The court said that an implied cause of action could be established by the courts to effectuate the congressional purpose and federal policy behind the 1934 Act. In so holding, the court relied on *J. I. Case v. Borak*, 377 U.S. 426. The court in *Colonial Realty* said that it would recognize an implied cause of action where the rule violated; (1) amounted to a substitute for an SEC regulation, and (2) established an explicit duty unknown to the common law. 358 F.2d at 182.

Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 7 Cir., 410 F.2d 135, *cert. denied* 396 U.S. 838, recognized an implied cause of action under NYSE Rule 405. The court said that determination of whether violation of a rule is actionable depends on whether its design is "for the direct protection of investors" and said one of the functions of Rule 405 was the protection of the public. *Ibid.* at 142. Critics of the *Buttrey* decision have pointed out that Rule 405 was not promulgated to protect customers from shady brokers but rather to protect brokers from unscrupulous customers. This criticism has its basis in SEC, Report of Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. No. 95, 88th Cong. 1st Sess., pt. 1, at 316.

In *Buttrey* the court did not say that an alleged violation of Rule 405 was per se actionable. 358 F.2d at 142. The complaint there under consideration alleged fraudulent conversion of securities. The court said, *Ibid.* at 143, that "the facts alleged here are tantamount to fraud * * *, thus giving rise to a private civil damage action."

The district courts of the Tenth Circuit are split on whether an implied cause of action may be based on NASD or stock exchange rules. No implied cause of action is recognized in *Thompson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, W.D.Okl., 401 F.Supp. 111, and in *Utah v. duPont Walston, Inc.*, D. Utah, CCH Fed. Sec. Rptr. ¶ 94,812 at p. 96,713. A contrary result is reached in *Geyer v. Paine, Webber, Jackson & Curtis, Inc.*, D.Wyo. 389 F.Supp. 678.

In *Ocrant v. Dean Witter & Company, Inc.*, 10 Cir., 502 F.2d 854, by way of dicta, and citing *Buttrey*, we recognized that "in an appropriate case, violations of exchange rules designed for customer protection might give rise to a private cause of action * * *." *Ibid.* at 858.

The statement in *Ocrant* is pertinent. In an appropriate case a rule violation may give rise to a private cause of action. At the same time there is good reason to limit the scope of potential liability of brokers for rule violations. The advantages of self-regulation in the securities field may not be denied. Self-regulation obviates need for a

more massive governmental bureaucracy and a detailed and rigid regulation of the entire securities field. See S.Rep. No. 1455, 75th Cong. 3d Sess., 3-5, and H.R.Rep. No. 2307, 75th Cong. 3d Sess. 4-5. See also *Silver v. New York Stock Exchange,* 373 U.S. 341, 352. For the system to work effectively, the self-regulatory bodies must be encouraged to take the initiative in exploring and formulating new rules to govern the conduct of their members. Such action is doubtful if the promulgation of every new rule has the potential of creating massive liability for the members.

No provision of the Securities Exchange Act creates and express civil remedy for violation of an exchange or association rule. In *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, the Supreme Court rejected a private implied claim for violation of SEC Rule 10b-5. The Court said, *Ibid.* at 207, that: "In each instance that Congress created express civil liability in favor of purchasers or sellers of securities it clearly specified whether recovery was to be premised on knowing or intentional conduct, negligence, or entirely innocent mistake." With reference to Rule 10b-5, the Court said, *Ibid.* at 206, that: "There is no indication that Congress intended anyone to be made liable for such practices unless he acted other than in good faith."

Applying the statements of the Court to claims asserted under association and exchange rules, something more than mistake or negligence must be shown. The allegations of the complaints are that the stocks were too speculative for USU, did not have earnings records showing suitability for purchase by USU, the stocks were purchased in too great quantities, the stocks were too thinly traded, and the purchase of the stocks by USU was *ultra vires.* No complaint has an allegation of fraud or bad faith. The allegations, taken separately or together, are not tantamount to fraud.

The argument that the brokers are liable because they should have known that the stock purchases by USU were illegal under Utah law does not impress us. USU seeks to take advantage of its own wrongful acts. It would retain the profits which it has made and recover from the brokers the losses which it has sustained. An *ultra vires* act of an institutional customer may not be converted into a wrongful act of a broker.

The fact that the brokers did not foresee the decision of the Utah Supreme Court made three years after the transactions in question does not establish fraud, or conduct tantamount to fraud, on the part of the brokers.

The complaints show that USU had a large stock portfolio covering thousands of shares in many diverse companies. The stocks were bought and sold through numerous brokers. No claim is made of overreaching, misrepresentation, manipulation or deception. The allegations of unsuitability for an institutional investor such as USU do not establish a claim of fraud or of misconduct tantamount to fraud. We recognize that in an appropriate case there may be an implied cause of action for private redress for violation of association or exchange rules. None of the cases before us are within that category. The trial court properly dismissed the claims based on the NASD, NYSE, and AMEX rules.

Section 10b and Rule 10b-5.

The USU claims under § 10b of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder are based on its allegations of violations of the NASD, NYSE, and AMEX rules. *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, holds that for a private cause of action to lie under § 10b or Rule 10b-5, there must be allegations of scienter-intent to deceive,

manipulate or defraud. None of the complaints plead scienter. A claim of violations of the NASD, NYSE, and AMEX rules does not take the place of the scienter requirement. Willful or intentional misconduct, or the equivalent thereof, is essential to recovery by USU under either the statute or the regulation. *Ibid.* at 201. In the absence of the needed allegations, *Hochfelder* applies and requires the dismissal of the § 10b and Rule 10b-5 claims.

Regulation T.

Section 7 of the Securities Exchange Act of 1934, 15 U.S.C. § 78g, relates to margin requirements. Subsection (a) declares its purpose to prevent "the excessive use of credit for the purchase or carrying of securities." Subsection (c) provides that it is unlawful for a broker "directly or indirectly, to extend or maintain credit * * * for any customer — (1) on any security * * *, in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System shall prescribe * * *." Regulation T was so prescribed. 12 C.F.R. Part 220. In essence it requires a broker to liquidate a customer's order if payment is not received within seven days from the date of purchase. If the customer in good faith agrees to make full cash payment upon delivery of the security, payment may be delayed until delivery which must take place within 35 days of the purchase. 12 C.F.R. § 220.4(c)(5).

The complaints charge that all of the brokers except Sutro & Co. violated the regulation. The complaints have no allegation that USU ever complained to any broker because of delay in delivery and payment. The complaints say that USU maintained a cash account with each broker; that as to specific stocks payment was not made in 35 days; that the broker did not cancel the purchase or liquidate the transaction; and that specified stocks were sold at a loss.

The complaints show that some stocks delivered and paid for after the 35-day period had not been sold by USU. The complaints do not allege that any particular stock or stocks, if delivered and paid for within the 35-day period, could have been disposed of without loss. USU wants its money back on stocks which at some undisclosed time were sold at a loss. The sole basis for the USU claims is failure to liquidate the transaction when payment was not made within the Regulation T time limits.

Pearlstein v. Scudder & German, 2 Cir., 429 F.2d 1136, *cert. denied* 401 U.S. 1013, recognized an implied cause of action for a customer under Regulation T. The court said that knowing participation of the customer in the violation did not bar recovery because the statute made it illegal to extend credit but not to receive it. *Ibid* at 1141. One judge dissented saying that the purpose of the margin requirements was to protect the overall economy from excessive speculation and that the protection against a speculator extending himself too thinly was only a by-product. *Ibid.* at 1147. An implied cause of action under Regulation T was also recognized in *Spoon v. Walston & Co., Inc.,* 6 Cir., 478 F.2d 246, and *Landry v. Hemphill, Noyes & Co.,* 1 Cir., 473 F.2d 365, *cert. denied* 414 U.S. 1022.

In 1970 Congress amended the 1934 Act by adding § 7(f). 15 U.S.C. § 78g(f), which declares that it is illegal for any person to obtain, receive, or enjoy the extension of credit in connection with the purchase of securities contrary to the Federal Reserve System regulations. The Board of Governors of the Federal Reserve to implement the amendment promulgated Regulation X, 12 C.F.R. Part 224, which prohibits any person from obtaining credit when to do so would cause the creditor to violate Regulation T.

The primary purpose of the 1970 amendment was to promote the stability of the securities markets. See 2 U.S.

Code Cong. & Admin. News '70, 4409-4410. The responsibility for compliance with the margin requirements is now on the customer as well as the broker. *Pearlstein, Spoon, and Landry* all concerned transactions occurring before the effective date of Regulation X. The statement in *Pearlstein*, 429 F.2d at 1141, that "Congress has placed the responsibility for observing margins on the broker" no longer applies. When the *Pearlstein* case came back to the Second Circuit after remand, the court, after referring to the 1970 amendment and Regulation X, said in *Pearlstein v. Scudder & German*, 2 Cir., 527 F.2d 1141, 1145, n. 3.:

> "The effect of these developments is to cast doubt on the continuing validity of the rationale of our prior holding."

Two district court decisions discuss at some length the impact of Regulation X on Regulation T. They are *Bell v. J. D. Winer & Co., Inc.*, S.D.N.Y., 392 F.Supp. 646, and *Freeman v. Marine Midland Bank - New York*, E.D.N.Y., 419 F.Supp. 440. In *Bell* the legislative history of the statutes underlying the two regulations is presented at length and we need not repeat it here. On the facts presented, *Bell* rejected the private implied cause of action asserted under Regulation T. *Freeman* agrees with the reasoning in *Bell*, but allows the private cause of action because the events giving rise to the action occurred before the promulgation of Regulation X. *Neill v. David A. Noyes & Co.*, N.D.Ill., 416 F. Supp. 78, which recognizes a private claim under Regulation T, is not pertinent because the complaint alleged fraud and deceptive conduct. See also *Lantz v. Wedbush, Noble, Cooke, Inc.*, D. Alas., 418 F.Supp. 653, a decision pertaining to the defense of *in pari delicto*.

Under Regulation X, the broker is subject to criminal penalties and the customer is not, if the credit is obtained innocently and, if upon learning of the violation, he makes

payment. This difference in criminal penalties is no reason for imposing civil liability on the broker. The imposition of that liability places the customer in a "heads I win — tails you lose" position. If the stock goes up, he takes his profit. If it goes down, he recovers his loss from the broker. Congress imposed the margin requirements to protect the general economy, not to give the customer a free ride at the expense of the broker.

Because of our conclusion that no private cause of action exists for violations of Regulation T, it is not necessary for us to consider that alternative action of the trial court allowing summary judgment for the defendants on the Reguation T claims.

The Merrill Lynch Cases.

Nos. 75-1862 and 76-1330 are USU appeals from judgments in favor of Merrill Lynch. The situation is somewhat different from that presented and considered in the other six appeals. In the *Merrill Lynch* cases the State of Utah was named as a plaintiff in the complaint, but did not join in the notices of appeal.

The initial *Merrill Lynch* complaint differs from the others in that the claim is asserted that the facts alleged in the counts pertaining to the violations of the NASD, NYSE, and AMEX rules also violate Rule 10b-5. We have held that on the record presented, violation of the association and exchange rules do not give rise to a private cause of action. No different result is mandated by joining the rule violations with a Rule 10b-5 claim. It adds nothing to combine the allegations. The conclusory statement in this complaint that the violations of the exchange and association rules "operated as a fraud and deceit upon the plaintiffs" is insufficient to sustain a claim of fraud or

deceit. The circumstances constituting fraud must be stated with particularly. Rule 9(b), F.R.Civ.P.

Merrill Lynch filed a motion for judgment on the pleadings rather than a motion to dismiss. We have no reason to explore the technical differences between a Rule 12(b), F.R.Civ.P., motion to dismiss for failure to state a claim upon which relief can be granted and a Rule 12(c) motion for judgment on the pleadings. Our decision is based upon the legal sufficiency of the complaints. The trial court did not err in granting Merrill Lynch judgment on the pleadings.

The other *Merrill Lynch* complaint differs in that, with regard to Regulation T, reliance is not placed on the 35-day provision but on the provision requiring payment within seven days of purchase. We agree with the trial court that with regard to the customer's right to maintain an implied action against the broker for violation of Regulation T, it makes no difference whether reliance is had on the seven day or the 35-day provision.

The judgments in the appeals noted in the caption are severally affirmed.

APPENDIX B

Filed in United States District Court, District of Utah
July 8, 1975 — Verl C. Ritchie, Clerk

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH — NORTHERN DIVISION

UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate, *Plaintiff*, v. BEAR, STEARNS & Co., a corporation, *Defendant*.	NC 74-38
UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate, *Plaintiff*, v. BLYTH EASTMAN DILLON & CO., INC., a corporation, *Defendant*.	NC 74-39
UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate, *Plaintiff*, v. BOSWORTH, SULLIVAN & COMPANY, INC., a corporation, *Defendant*.	NC 74-40
UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate, *Plaintiff*, v. HARRIS, UPHAM AND CO., INC., *Defendant*.	NC 74-41

UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate, *Plaintiff,* v. HORNBLOWER & WEEKS — HEMPHILL, NOYES, INC., *Defendant.*	NC 74-42
UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate, *Plaintiff,* v. LEHMAN BROTHERS, INC., *Defendant.*	NC 74-43
UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate, *Plaintiff,* v. SHEARSON, HAMMILL & CO., INC., *Defendant.*	NC 74-44
UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate, *Plaintiff,* v. SUTRO & CO., *Defendant.*	NC 74-45
THE STATE OF UTAH, and UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate, *Plaintiffs,* v MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., a corporation, *Defendant.*	NC 74-46

MEMORANDUM OPINION AND ORDER GRANTING DEFENDANT MERRILL LYNCH'S MOTION FOR JUDGMENT ON THE PLEADINGS AND ALL OTHER DEFENDANTS' MOTIONS TO DISMISS ON COUNTS I, II, III, IV and V OF THE COMPLAINTS AND DISMISSING THE PENDENT CLAIMS BASED ON STATE LAW THEORIES.

Vernon B. Romney, Utah Attorney General and David L. Wilkinson, Assistant Utah Attorney General, Salt Lake City, Utah, for plaintiff in all the above-entitled matters, and Richard W. Giauque and Brent M. Stevenson of Van Cott, Bagley, Cornwall and McCarthy, Salt Lake City, Utah, for plaintiffs in NC 74-46.

Keith E. Taylor, Daniel M. Allred and Krege B. Christensen of Parsons, Behle & Latimer, Salt Lake City, Utah, for defendants Bear, Stearns & Co., NC 74-38; Harris, Upham & Co., Inc., NC 74-41; Hornblower & Weeks — Hemphill, Noyes, Inc., NC 74-42; Lehman Brothers, Inc., NC 74-43; Shearson, Hammill & Co., Inc., NC 74-44; Sutro & Co., Inc. NC 74-45; and Merrill Lynch, Pierce, Fenner & Smith, Inc., NC 74-46.

Parker M. Nielson of Salt Lake City, Utah, for defendant Blyth Eastman Dillon & Co., Inc., NC 74-39.

Harold G. Christensen and R. Brent Stephens of Worsley, Snow & Christensen of Salt Lake City, Utah, for defendant Bosworth, Sullivan & Company, Inc., NC 74-40.

On September 20, 1974, plaintiff[1] in the above-entitled matters filed suits against the nine named stock brokerage firms. As set out below, the cases arise from similar investment transactions in the same investment program carried on by Utah State University [hereinafter the University] and in most cases the allegations in plaintiff's

[1]The University is the sole plaintiff in each of the actions with the exception of the suit filed against Merrill Lynch, NC 74-46, in which case the State of Utah is also named as a party plaintiff. A reference herein to the "University" or to the "plaintiff" is intended to embrace both plaintiffs in NC 74-46.

complaints and the defenses thereto are identical.[2] Although the cases have not been consolidated, they have been processed simultaneously and argued together, and this order will apply to all the cases as set out above.

In these actions the plaintiff University seeks to recover losses arising out of certain investments it made in common stock through the various defendant brokerage firms. For a period of time subsequent to June, 1970, the then Assistant Vice President of Finance of the University and the University's investment officer, made numerous investments in securities on behalf of the University and executed such investments through various securities brokerage houses in Utah and elsewhere, some of which are named as defendants in the actions herein. Many of the aforesaid investments were in common stocks, the market price of some of which declined markedly subsequent to the University's investment, allegedly resulting in substantial loss to the University.

On November 15, 1974, all the defendants filed a motion to dismis pursuant to Fed. R. Civ. P. 12(b), 8(e)(1), and 9(b)[3] except defendant Merrill Lynch who, on that day, filed a motion for judgment on the pleadings pursuant to Fed. R. Civ. P. 12(c). These motions were accompanied by memoranda in support thereof and the parties have filed extensive memoranda since that time; to wit, plaintiff filed a memorandum in opposition to the aforementioned motions on December 11, 1974; defendants filed a reply memorandum in support of their motions on December 17, 1974; plaintiff filed a supplemental memorandum in opposition on December 19, 1974; and on February 4 and 11, 1975, the parties filed post-hearing memoranda in support of their respective positions. Oral argument was requested by all of the parties and was heard, with counsel for all of the parties present and participating, on January 29 and 30, 1975, at which time the matter was taken under advisement. On May 5, 1975, the court filed an order allowing the parties to file affidavits or other supporting materials in support of certain factual allegations made in their motions and memoranda in order that the pending motions to dismiss could alternatively be treated by the court as motions for summary judgment pursuant to Fed. R. Civ. P. 12(b).

[2]Each case has the same variety except NC 74-43 and NC 74-45 which do not have a count based upon the alleged violation of Regulation T, promulgated by the Board of Governors of the Federal Reserve System under Section 7(a) and (c) of the Securities Exchange Act of 1934.

[3]The motion to dismiss of defendant Bosworth, Sullivan & Co., Inc., was filed pursuant to Fed. R. Civ. P. 12(b) only.

COUNTS I, II AND III OF THE COMPLAINTS.

Counts I and II of each complaint allege violations of section 15A of the Securities Exchange Act of 1934, 15 U.S.C. § 78o-3, and of the National Association of Security Dealers (hereinafter NASD) Rules of Fair Practice, Article III, § 1[4] and §2[5] promulgated by NASD thereunder. Count III is similar in nature and is based upon an alleged violation of section 6 of the 1934 Act, 15 U.S.C. § 78f and upon Rule 405 ("Know-Your-Customer Rule") of the New York Stock Exchange and Rule 411 of the American Stock Exchange (which is similar to said Rule 405), promulgated by the respective stock exchange thereunder.

In *State of Utah v. duPont Walston, Inc., et al.,* CCH

[4]This rule provides:

> "A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade."

[5]This is the NASD "suitability rule" which states that: "In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."

SEC. L. REP ¶ 94,812, at 96,713 (D.C. Utah, October 1, 1974) (hereinafter cited as *duPont*), this court decided that a private right of action does not exist for the aggrieved customer to sue a broker-dealer in federal court for violation of a rule of one of the self-regulatory bodies to which the broker-dealer belongs. Counts I, II and III of all of the complaints, except the *Merrill Lynch* complaint, NC 74-76, are virtually identical, both in form and in substance, to the complaint in *duPont*. Therefore, based upon the court's ruling in *duPont*, defendants'[6] motions to dismiss are hereby granted as to Counts I, II and III for failure to state a claim upon which relief can be granted.

Counts I, II and III in the *Merrill Lynch* complaint are different from their counterparts in the other complaints in that an allegation is made that the facts alleged in the first three counts also violate Rule 10b-5. It appears that plaintiffs in the *Merrill Lynch* complaint seek to buttress a Rule 10b-5 claim with reference to the NASD and Stock Exchange Rules as these rules might bear upon the duty owed to the plaintiffs by defendants. Since the court has already ruled that alleged violations of these rules do not give rise to a private right of action, it is difficult to conceive what different result or advantage plaintiffs might seek, evidentiary or otherwise, by combining the alleged violations of the rules with a 10b-5 claim. If the violation of the aforementioned rules cannot sustain a private right of action standing alone, it adds nothing to combine these allegations with alleged Rule 10b-5 violations, especially when Count IV of the complaint alleges a separate Rule 10b-5 claim. Thus, for the reasons set forth above in regard to the unavailability of a private right of action under the aforementioned rules and with the reasons set forth below regarding the Rule 10b-5 count of the

[6]All defendants are contemplated except Merrill Lynch in NC 74-46.

complaint, Counts I, II and III of the *Merrill Lynch* complaints, NC 74-46, are dismissed as being cumulative and redundant.

COUNT IV ALLEGED RULE 10b-5 VIOLATIONS

Count IV of each complaint alleges a violation of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5. Count IV, in essence, alleges that defendant omitted to state certain material facts which were necessary in order to make the statements that the defendants did make, in connection with the purchase of securities by the plaintiff, not misleading. The alleged material omissions are the same allegations which are found in the first three counts of the complaints — the suitability claims against defendant under the NASD and Stock Exchange Rules.

Omissions concerning the suitability of a stock are not the kind of omissions which give rise to Rule 10b-5 or any antifraud liability. Professor Bromberg states:

> The embryonic requirement that a broker dealer's recommendation be "suitable" for his customers, primarily in terms of risk and their needs and situations, is a product of industry self-regulation.
>
> Except for "boiler-shop"[7] cases, it presently lies outside 10b-5 and other fraud rules. 1 BROMBERG, SECURITY LAWS: FRAUD, § 5.4, at 99-100 (1974), *accord*, VI L. LOSS, SECURITIES REGULATION 3720 (Supp. 1969).

The court has not been cited a case, nor has the court found a case, which has held on the merits that a broker-dealer's omissions concerning suitability of a stock is a basis for Rule 10b-5 liability. Disregardng the suitability

[7]"Boiler room" or "boiler-shop" is a high pressure sales campaign conducted by telephone. *See VI* L. LOSS, SECURITIES REGULATION 3708 (Supp. 1969).

allegations in Count IV, which do not give rise to Rule 10b-5 liability, the complaint fails to state a claim upon which relief can be granted. Therefore, Counts IV of plaintiffs' complaints are dismissed, pursuant to Fed. R. Civ. P. 12(b)(6), for the reasons set forth herein.

REGULATIONS T AND X

Except for the complaints against Lehman Brothers, Inc. and Sutro & Co., Inc., the University alleges in Count V of the complaints a violation of Regulation T of the Federal Reserve Board by defendants. The University further alleges that it maintained a special cash account with each of the defendants, and although it did not make payment within 35 days from the trade date of certain enumerated purchase transactions, the defendants did not cancel the purchases or otherwise liquidate the University's accounts, nor did the defendants apply for an extension of time as required by Regulation T.

Regulation T, promulgated pursuant to section 7(c) of the Securities Exchange Act of 1934, 15 U.S.C. § 78g(c), determines the initial minimum margin requirements that brokers and dealers may extend to their customers. Basically, a margin requirement is the amount of down payment required on any given security purchased on credit. When, as in these cases, a special cash account is used, the purchases or sales are essentially cash, not credit transactions.[8] If the cash, in the case of a purchase, is not deposited in the account within the required time,[9] the broker-dealer must, subject to certain limitations, liquidate the account.

[8] 12 C.F.R. § 220.4 (1973).

[9] The required time in the case of a purchase through a special cash account is seven business days. 12 C.F.R. § 220.4(c)(ii)(2) (1973). However, as in this case, if payment is to be made against the delivery of the security by the broker, the required period may be extended to thirty-five days. 12 C.F.R. § 220.4(c)(ii)(5)(1973).

Thus, a Regulation T violation occurs most generally when the broker-dealer fails to make a timely liquidation.

The main purpose behind section 7 of the 1934 Act, under which Regulation T was promulgated, was set forth in the report of the House Committee on Interstate and Foreign Commerce:

> The main purpose of these margin provisions . . . is not to increase the safety of security loans for lenders. Banks and brokers normally require sufficient collateral to make themselves safe without the help of law. Nor is the main purpose even protection of the small speculator by making it impossible for him to spread himself too thinly — although such a result will be achieved as a byproduct of the main purpose.
>
> The main purpose is to give a Government credit agency an effective method of reducing the aggregate amount of the nation's credit resources which can be directed by speculation into the stock market and out of other more desirable uses of commerce and industry — to prevent a recurrence of the pre-crash situation where funds which would otherwise have been available at normal interest rates for uses of local commerce, industry and agriculture, were drained by far higher rates into security loans and the New York call market.
> H.R. Rep. No. 1383, 73d Cong., 2d Sess. 8 (1934).

As seen from the foregoing, only secondarily was the interest of lenders-brokers and investors considered.

While no civil remedy for margin violations exists under the 1934 Act, and even without the primary purpose of section 7 being the protection of the investor, courts have nevertheless been willing to imply a private right of action for investors from a mere Federal Reserve Board regulation based on one of three theories: tort, enforce-

ment, or contract.[10] Until recently the margin requirements, through Regulation T, were addressed exclusively to those who extended credit in securities transactions and, consequently, in any transaction in which credit for the purchase of securities was involved, the lender had the burden of observing margin requirements.

In 1971, Congress amended section 7 of the 1934 Act to prohibit the receipt of loans by investors in violation of the margin requirements.[11] This legislation was implemented through another Federal Reserve Board regulation, Regulation X. Regulation X makes unlawful an investor's obtaining of any credit in violation of the margin requirements; however, there is no violation if the borrower makes a good faith mistake and, upon discovery of the mistake, promptly takes whatever steps necessary to remedy the non-compliance.[12]

In passing Title III of the Bank Records and Foreign Transactions Act, under which Regulation X was promulgated, Congress was concerned with deterring tax evasion and other criminal activities.[13] Regulation X has as its stated purpose:

> [T]o prevent the infusion of unregulated credit obtained both outside and within the United States securities markets in circumvention of the provisions of the Board's margin regulations or by borrowers falsely certifying the purpose of a loan or otherwise wilfully and intentionally evading the provisions of those regulations.[14]

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[10] *See* Note, *In pari delicto as a Defense to Violations of Margin Legislation under the Securities and Exchange Act of 1934*, 9 U. SAN FRANCISCO L. REV. 113, 118-19 (1974); Note, *Regulation X: A Complexis*, 50 NOTRE DAME LAWYER 136 (1974).

[11] BANK RECORDS & FOREIGN TRANSACTIONS ACT OF 1970, TITLE III, 84 Stat. 1124, 15 U.S.C. § 78g(f)(1) (1971).

[12] 12 C.F.R. § 224.1 (1973).

[13] *See* H.R. Rep. No. 975 91st Cong., 2d Sess. 12 (1970).

[14] 12 C.F.R. § 224.1 (1973).

Both Regulations T and X were promulgated under section 7 of the 1934 Act and the purposes of both regulations are aimed at realizing or stabilizing a desirable macroeconomic goal of Congress rather than the protection of investors.

While an implied right of action under Regulation T has been granted by some courts, the promulgation of Regulation X and the facts of this case put the issue of the interface of the two regulations directly before the court. Regarding the status of the private right of action in light of the interface, at least four different results can be suggested: (1) The basis for a private damage action for violation of Regulation T has been undermined and canceled out by the amendment of section 7 of the 1934 Act and the promulgation of Regulation X thereunder for the reason that in the past under Regulation T the broker shouldered the entire responsibility for compliance with the margin requirements, but Regulation X now puts the responsibility equally upon the investor. (2) The private right of action survives in the face of the promulgation of Regulation X; however, Regulation X provides an *in pari delicto* or equal fault defense in an action by an investor that the court or jury can manipulate in making a determination as to the degree of culpability of each party. (3) The private right of action survives in the face of the promulgation of Regulation X, unless the investor has wilfully and intentionally tried to evade the provisions of the margin requirements.[15] (4) The private right of action

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[15] The first paragraph of Regulation X states its purpose as follows:

> [T]o prevent the infusion of unregulated credit obtained both outside and within the United States securities markets in circumvention of the provisions of the Board's margin regulations or by borrowers falsely certifying the purpose of a loan or otherwise ***wilfully and intentionally*** evading the provisions of those regulations. 12 C.F.R. § 224.1 (1973). (Emphasis added.)

The court reads this provision in two parts. The first part (ending at the first conjunction "or") explains the purpose of Regulation X in terms of

survives in the face of the promulgation of Regulation X and a broker can expose himself to almost strict liability for a violation of Regulation T for the reason that someone should be saddled with the responsibility of assuring compliance with the margin requirements and the broker is in the best posture to do this. The *in pari delicto* defense would be denied under this approach for the reason that private suits serve an important enforcement function and this enforcement purpose would disallow an *in pari delicto* defense in the securities area as it has been disallowed in the antitrust area.[16]

The court is of the opinion that, as outlined in the first alternative, the promulgation of Regulation X has removed the necessary legal underpinning for implying a private right of action for a violation of the margin requirements, and that Regulation X cancels out the private right of action implied under Regulation T. As a matter of law, therefore, Count V in the complaints which alleges a violation of Regulation T should be dismissed for failure to state a claim upon which relief can be granted. Further, however, the court is of the opinion that motions for summary judgment would have to be granted in favor of defendants for other reasons under the facts of these cases.

Most private actions under Regulation T have been brought in tort on the rationale that where a defendant's

preventing the infusion of unregulated credit, the mere circumvention of the margin regulations. The second part (following the first conjunction "or") speaks of preventing the false certification of the purpose of a loan, and the phrase "or otherwise wilfully and intentionally evading" is thought to refer only to "falsely certifying the purpose of a loan."

To conclude that an investor need not have a wilful intent to evade the margin requirements in order to violate Regulation X is consistent both with the obvious construction of the stated purpose of the regulation as herein explained and with the tenor of Regulation T and the federal securities fraud laws which do not require wilfulness in order to show a violation.

[16]See *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134, 138 (1968).

violation of a prohibitory statute has caused injury to the plaintiff, the latter has a right of action if one of the purposes of the enactment is to protect interests similar to those of the plaintiffs. The implication of a private right of action under Regulation T was based upon an enactment and a regulation promulgated thereunder, neither of which had as their purpose the protection of the investor. To find a basis on which to predicate liability under Regulation T, a secondary effect of shielding the investor from spreading his resources too thinly has been recognized.[17] In light of the amendment to section 7 of the 1934 Act by Congress and the promulgation of Regulation X thereunder, it appears tenuous to continue to elevate what the report of the House Committee on Interstate and Foreign Commerce characterized as a "by-product" effect[18] into a "purpose" of the enactment and then to imply from this implied purpose a private right of action for an investor, who now, like the lender, violates the law by carrying securities with the credit obtained in a transaction involving a Regulation T violation. In 1970 when Congress considered and amended the margin provisions in section 7 of the 1934 Act, a private remedy could have been provided at that time. Instead, however, Congress dealt only with countering secret foreign financing in circumvention of the margin regulations. Commenting on the policy implicatons of Regu-

[17]*Remars v. Clayton Securities Corp.*, 81 F. Supp. 1014, 1017 (D. Mass. 1949). *See also,* H. R. Rep. No. 1383, infra note 18, in which deterring the investor from spreading himself too thinly was seen as a "by-product" of the main purpose of the regulation.

[18]The report of the House Committee on Interstate and Foreign Commerce stated:

> The main purpose of these margin provisions . . . is not to increase the safety of security loans for lenders. Banks and brokers normally require sufficient collateral to make themselves safe without the help of law. Nor is the main purpose even protection of the small speculator by making it impossible for him to spread himself too thinly — although such a result will be achieved as a by-product of the main purpose. H.R. Rep. No. 1383, 73d Cong., 2d Sess. 8 (1934).

lation X, the court in *S.E.C. v. Packer, Wilbur & Co., Inc.*, 362 F. Supp. 510, 515 (S.D.N.Y. 1973) stated: "The clear import of Regulation X is that Congress was determined not to limit the burden of compliance to brokers alone but rather extended it to customers as well."

The court, under the circumstances, credits Congress with adequate insight to provide enforcement of its own enactments. When Congress, with the knowledge that for years a private right of action had been implied by some courts under section 7 of the 1934 Act, amends the section in a manner which directly undercuts the legal basis upon which the private right of action was grounded and fails to directly authorize a private right, it would seem pretentious for this court to expand an area of federal law so recently considered by Congress by "implying" a private damage action for those guilty of margin violations under the law. For these reasons, the court holds that a private right of action no longer exists under Regulation T due to the amendment to section 7 of the 1934 Act which resulted in the promulgation of Regulation X.[19] Therefore, Counts V of plaintiff's complaints are dismissed.

[19]The court is aware of the leading Regulation T decision of the Second Circuit, *Pearlstein v. Scudder & German*, 429 F.2d 1136 (2nd Cir. 1970), *cert. denied*, 401 U.S. 1013 (1971) which concluded that the disadvantages of giving the "unscrupulous" plaintiff a windfall recovery were outweighed by the "salutary policing effect" a private cause of action would have upon broker-dealers. *Id.* at 1141. The *Pearlstein* decision rejected the defense of *in pari delicto* in a suit alleging violation of Regulation T. However, the reasoning employed for that conclusion has been undermined by the subsequent enactment of Regulation X. The Pearlstein Court, as analogous authority, specifically referred to the antitrust decision of *Perma Life Mufflers v. International Parts*, 392 U.S. 134 (1968), which had rejected the *in pari delicto* defense in the antitrust area. In expanding on that analogy, the Second Circuit pointed out that

> [a]lthough *Perma Life* would apparently continue to deny recovery to plaintiffs who had not been coerced but who had benefited from the arrangement equally with the defendant, such a defense does not appear desirable in the securities area here involved, even when the investor may be shown to have had knowledge of margin requirements. Unlike the antitrust laws which forbid both seller and buyer to enter into a proscribed transaction, the federally imposed margin requirements forbid a broker to extend undue credit but do not forbid customers from accepting such credit. 429 F.2d at 1141.

The court further observes that even if it be argued that a private right of action should still be implied in the face of Regulation X, the authorities do not support such an implication on behalf of an institutional investor as in this case. As Judge Friendly observed in a persuasive dissent in *Pearlstein v. Scudder & German*, 429 F.2d 1136, 1148 (2nd Cir. 1970), *cert. denied*, 401 U.S. 1013 (1971):

> To be sure, it may be proper in some instances to impose civil liability in furtherance of the subsidiary purpose of § 7(c), protection of the innocent "lamb" attracted to speculation by the possibility of large profits with low capital investment. . . . Pearlstein, an experienced speculator, was no lamb, and the trial judge specifically found that he was not induced to enter into the transactions by any expectation that defendant would be slow in selling him out if he were to default in payment.

The University, an institutional investor (and an agency of the sovereign) which must operate under guide-

The premise of that position — that buyers are not prohibited from entering into improper margin transactions — has been overruled by Regulation X. Thus, the primary ground of the *Pearlstein* argument for rejecting the *in pari delicto* defense in Regulation T cases is no longer valid. In addition, the analogy to the private policing policy of antitrust laws is weak at best, since those statutes specifically provide for private civil actions and encourage private enforcement actions by the treble damages provisions. In contrast, no such Congressional imprimatur exists for private actions under Regulation T. Thus, antitrust cases such as *Perma Life* are inappropriate authority in this case for rejecting the *in pari delicto* defense, or even for the importance of a private right of action.

In *Pearlstein* Judge Friendly dissented on the ground that the holding would encourage customers to violate the margin rules. 429 F.2d 1148. A similar argument could be made against the court's holding in the instant case; that is, by abolishing a private right of action altogether, the incentive to comply with margin requirements is reduced for both broker-dealers and customers and, as a consequence, "devil's bargains" might result, depending upon the probabilities of detection through public enforcement. The court believes, however, that the potential for this kind of abuse is diminished by the current disinclination of broker-dealers to jeopardize their public image, their relationship with the SEC, and their standing among other broker-dealers in the industry. There are a sufficient number of other enforcement avenues of the regulations in question.

lines established by statutes, regulations and rules, engaged itself in a far-flung, wide-ranging investment program in common stocks which it now asserts it had no authority to do. Neither the main purpose of section 7(c) — e.g., ". . . to prevent a recurrence of the pre-crash situation where funds which would otherwise have been available at normal interest rates for use of local commerce, industry and agriculture. . . ."[20] — nor the secondary purpose — e.g., the ". . . protection of the small speculator by making it impossible for him to spread himself too thinly. . . ."[21] — are served by implying a private right of action under the facts of this case. The funds that were invested by the University would not, directly at least, be available to support local commerce, industry and agriculture, nor can the University be said to be the "small speculator" concerning whom Congres might have had secondary concern in making it impossible to spread itself too thinly. A threshold requirement of serving or forwarding the public purposes of section 7(c) of the 1934 Act must be met before a private right of action for civil liability can be implied thereunder. The rationale that argues for implying a private right of action for a financially strong institutional investor under either the primary or secondary purpose of section 7(c) hangs from a thin, fragmented thread. The court is unaware of any authority under which private civil liability should be implied or sustained in this case.

Lastly, even if a private right of action should still be implied in the face of Regulation X and the other considerations set out above, at the very least, Regulation X would provide an *in pari delicto* or equal fault defense which would sustain a motion for summary judgment in favor of defendants under the facts of this case. Regulation X makes the University equally responsible and liable with

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[20]H.R. Rep. No. 1383, 73d Cong., 2d Sess. 8 (1934).

[21]*Id.*

the defendants for the alleged margin violations. Ignorance of the law is generally no defense when charged with its violation; however, in this regard, the University cannot be characterized as unknowledgeable with regard to the requisites of Regulation X when it had ready access to legal counsel and also had available to it the experience and manpower of the office of the Utah Attorney General, itself a law enforcement agency, charged with advising various state agencies concerning the exercise of their powers. It is interesting to observe that the court has not been advised that the University took advantage of that portion of Regulation X which allows a purchaser to correct a non-compliance by promptly taking whatever remedial steps are necessary upon discovery of the violation.[22] At best, therefore, the plaintiff's theory is novel, in that it seeks to selectively rescind and be made whole on all its loss transactions while keeping the benefits of its gain transactions. The court is unaware of any authority which would allow such a favorable remedy to a plaintiff who is equally guilty of violation of the regulation under which liability would be imposed against the defendant. Neither justice nor reason provide grounds on which to sustain a cause of action for the University's theory under all the circumstances of this case.

PENDENT CLAIMS BASED ON STATE LAW

In *State of Utah v. duPont Walston, Inc., et al.,* CCH SEC. L. REP. ¶ 94,812, at 96,713 (D.C. Utah, October 1, 1974), the court was concerned with the pendent state law claims, and the court's observations therein expressed are equally applicable again in these cases. In *United Mine Workers of America v. Gibbs,* 383 U.S. 715 (1966) the Supreme Court held that as a matter of constitutional power, pendent federal jurisdiction exists whenever state

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[22]12 C.F.R. § 224.6(a)(1973).

and federal claims "derive from a common nucleus of operative fact" and are such that a plaintiff "would ordinarily be expected to try them all in one judicial proceeding." *Id.* at 725. The Court, however, stated further in this regard:

> That power need not be exercised in every case in which it is found to exist. It has consistently been recognized that pendent jurisdiction is a doctrine of discretion, not of plaintiff's right. Its justification lies in considerations of judicial economy, convenience and fairness to litigants; if these are not present a federal court should hestitate to exercise jurisdiction over state claims, even though bound to apply state law to them, *Erie R. Co. v. Tompkins,* 304 U.S. 64. Needless decisions of state law should be avoided both as a matter of comity and to promote justice between the parties, by procuring for them a surer-footed reading of applicable law. *Certainly, if the federal claims are dismissed before trial, even though not insubstantial in a jurisdictional sense, the state claims should be dismissed as well.* Similarly, if it appears that the state issues substantially predominate, whether in terms of proof, of the scope of the issues raised, or of the comprehensiveness of the remedy sought, the state claims may be dismissed without prejudice and left for resolution to state tribunals. *Id.* at 726-27. (Emphasis added.)

These cases present a clear instance where state claims should be dismissed now that the determination has been made that there is no federal claim. The federal claims have been dismissed before trial. The remaining pendent claims involve complicated questions necessitating the construction of a morass of seemingly conflicting state statutes in order to determine the scope of power and authority of a state institution to invest in common stocks. This is a classic instance when "needless decisions of state law should be avoided . . . as a matter of comity . . . by procuring . . . a surer-footed reading of applicable law." Id. at 726.

It is appropriate to observe that the court is advised that by virtue of a state court suit brought by the University many of the issues involved in the pendent claims are on appeal to the Utah Supreme Court. It should be the primary right of the State Supreme Court to construe the state statutes involved in these pendent claims. It would be abortive for this court to decide questions so fundamentally fraught with state interests when the issues are on appeal before the Utah court. Therefore, based upon the foregoing reasons,

IT IS HEREBY ORDERED that defendant Merrill Lynch's motion for judgment on the pleadings[23] and all other defendants' motions to dismiss[24] on Counts I, II, III, IV and V of the complaints are granted for failing to state a claim upon which relief can be granted, and plaintiff's complaints are dismissed, along with the causes of action

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[23]The court is aware that a motion for judgment on the pleadings is theoretically directed towards a determination of the substantive merits of a controversy, but that it also has an incidental function under Fed. R. Civ. P. 12(h)(2) of permitting certain procedural defects, as in this case — a defense of failure to state a claim upon which relief can be granted — to be raised after the close of the pleadings. 5 WRIGHT & MILLER, FEDERAL PRACTICE AND PROCEDURE: Civil § 1369, at 701 (1969). The court, therefore, considers defendant Merrill Lynch's motion for judgment on the pleadings to be essentially in the same procedural posture as the other defendants' motions to dismiss filed pursuant to Fed. R. Civ. P. 12(b)(6).

[24]Although affidavits and other supporting materials have been filed by the respective parties, the court elects to ground its holding herein on the defendants' original motions to dismiss.

based thereon, and the remaining state law pendent claims are dismissed without prejudice.[25]

DATED this 8th day of July, 1975.

ALDON J. ANDERSON
United States District Judge

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[25]The court has noted the suggestion of plaintiff's counsel in its brief that for the reason that this court has previously upheld identical 10b-5 counts in the *duPont* complaint (NC 74-9) and in the *Merrill Lynch* complaint (NC 74-46), that amendment to the complaint might be allowed if the court had question as to the sufficiency of the 10b-5 counts. Plaintiff's arguments in this regard are not well taken and they inaccurately represent this court's prior rulings. In *duPont*, the defendant filed a motion to dismiss all counts in the complaint and the motion was granted only in respect to Counts I, II and III, which were the "suitability" counts as in the instant cases. However, when the defendant in *duPont* filed its motion to dismiss as to all counts, the complaint did not at that time contain a 10b-5 count. Plaintiff amended the complaint to include the 10b-5 count after the motion to dismiss was filed. The sufficiency of the 10b-5 count in *duPont* was never briefed, argued, or considered by the court. Further, the court has never ruled on the viability of the 10b-5 count in the *Merrill Lynch* complaint. Counts I, II and III in the *Merrill Lynch* complaint are, as the court has previously stated in this order, different from their counterparts in the other complaints in that they are bottomed on alleged violations of Rule 10b-5 as well as on alleged violations of the stock exchange rules in question. In this court's order of October 11, 1974, in the *Merrill Lynch* case, a motion to dismiss these three counts, on the grounds that a private right of action does not exist, was denied. In that order the court merely held that it read the complaint to allege a 10b-5 claim, rather than a claim based solely on the stock exchange rules. Today the court has considered the sufficiency of those three counts and has determined that they should be dismised, among other reasons, as being cumulative and redundant since Count IV of the *Merrill Lynch* complaint also alleges a 10b-5 violation. *Supra* at 7.

In view of the fact that plaintiff has chosen to stand on the 10b-5 pleading in its present form by not seeking opportunity to amend prior to the disposition of the motions to dismiss, and after now considering the nine complaints herein and the extensive briefing and argument in pretrial motions in which the court has not been advised nor become aware of even an oblique reference to any additional facts that might be pleaded in order to state a claim in this regard, amendment at this juncture appears futile. See *Forman v. Davis*, 371 U.S. 178, 182 (1962). For these reasons, the court does not construe plaintiff's suggestion that amendment might be allowed as a motion for leave to amend.

APPENDIX C

Filed in United States District Court, District of Utah
February 3, 1976 — Verl C. Ritchie, Clerk

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH—NORTHERN DIVISION

UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate,
Plaintiff,
vs.
MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., a corporation,
Defendant,

NC 75-58

ORDER GRANTING MOTION TO DISMISS

On December 8, 1975, the defendant in the above-entitled matter filed a motion requesting that the case be dismissed. The defendant also filed memorandum and other supporting materials. On December 30, 1975, the plaintiff filed a memorandum opposing the defendant's motion and the defendant filed a reply memorandum on January 9, 1976. The court has carefully considered the filed materials and considers itself to be well advised concerning the motion.

The basis of the defendant's motion is the contention that, as a matter of law, a violation by a broker-dealer of Regulation T promulgated by the Board of Governors of the Federal Reserve System (12 C.F.R. § 220) does not give rise to a private right of action. The defendant bases this contention on an order entered on July 8, 1975, by this court in a series of cases brought by the plaintiff, Utah State University, against several brokerage houses, includ-

ing the defendant in this case. See *Utah State University v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, NC 74-46. The plaintiff's response argues that this case should not be dismissed on the same grounds as the prior suit because a new legal theory is being advanced which requires that factual issues, relating to the defendant's good faith, be resolved. In its reply memorandum, the defendant argues that the addition of two new issues does not change the fact that, since the promulgation of Regulation X (12 C.F.R. § 224), Regulation T does not give rise to a private right of action.

For the reasons explained on pages 8 to 16 of the July 8, 1975, order in *Utah State University v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, NC 74-46, the defendant's motion should be granted.

IT IS HEREBY ORDERED that the defendant's motion to dismiss is granted.

DATED this 2nd day of February, 1976.

ALDON J. ANDERSON
United States District Judge

APPENDIX D

Regulation T of the Federal Reserve Board, 12 C.F.R. § 220 (1977):

.4(a)(1) Pursuant to this section, a creditor may establish for any customer one or more special accounts.

* * * *

.4(c)(1) In a special cash account, a creditor may affect for or with any customer bona fide cash transactions in securities in which the creditor may:

(i) Purchase any security for . . . any customer, provided funds sufficient for the purpose are already held in the account or the purchase or sale is in reliance upon an agreement accepted by the creditor in good faith that the customer will promptly make full cash payment for the security and the customer does not contemplate selling the security prior to making such payment.

* * * *

.4(c)(2) In case a customer purchases a security (other than an exempted security) in the special cash account and does not make full cash payment for the security within 7 days after the date on which the security is so purchased, the creditor shall, except as provided in subparagraphs (3)-(7) of this paragraph, promptly cancel or otherwise liquidate the transaction or unsettled portion thereof.

* * * *

.4(c)(5) If the creditor, acting in good faith in accordance with subparagraph (1) of this paragraph, purchases a security for a customer, with the understanding that he is to deliver the security promptly to the customer, and the full cash payment to be made by the customer is to be made against such delivery, the creditor may at his option treat the transaction as one to which the period applicable under subparagraph (2) of this para-

graph is not the 7 days therein specified but 35 days after the date of such purchase or sale.

* * * *

.4(c)(6) If an appropriate committee of a national securities exchange or a national securities association is satisfied that the creditor is acting in good faith in making the application, that the application relates to a bona fide cash transaction, and that exceptional circumstances warrant such action, such committee, on application of the creditor, (i) may extend any period specified in subparagraph (2) . . . or (5) of this paragraph for one or more limited periods commensurate with the circumstances.

* * * *

.4(c)(7) The 7-day periods specified in this paragraph refer to 7 full business days. The 35-day period and the 90-day period specified in this paragraph refer to calendar days, but if the last day of any such period is a Saturday, Sunday, or holiday, such period shall be considered to end on the next full business day.

Regulation X of the Federal Reserve Board, 12 C.F.R. § 224 (1977):

.2(a) A borrower shall not obtain any purpose credit from within the United States unless he does so in compliance with the following conditions:

* * * *

.2(a)(2) Credit obtained from a broker/dealer shall conform to the provisions of Part 220 of this chapter (Regulation T), which is hereby incorporated in this part (Regulation X). When the term "broker/dealer" is used in this part (Regulation X), it means a person who is a broker or dealer, including every member of a national securities exchange, and includes a foreign branch or subsidiary of a broker/dealer.

* * * *

.2(b)(1) A U.S. person or foreign person controlled by a U.S. person or acting on behalf of or in conjunction with such a person shall not obtain any purpose credit from outside the United States except in compliance with the following conditions:

* * * *

.2(b)(1)(ii) Credit obtained from a foreign branch or subsidiary of a broker/dealer shall conform to the provisions of Part 220 of this chapter (Regulation T).

.6(a) An innocent mistake made in good faith by a borrower in connection with the obtaining of a credit shall not be deemed to be a violation of this part (Regulation X) if promptly after discovery of the mistake the borrower takes whatever action is practicable to remedy the noncompliance.

APPENDIX E

Securities and Exchange Act of 1934, § 7, 15 U.S.C. § 78 g (1970):

> (a) For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Board of Governors of the Federal Reserve System shall, prior to October 1, 1934, and from time to time thereafter, prescribe rules and regulations with respect to the amount of credit that may be initially extended. . . .
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>
> (c) It shall be unlawful for any member of a national securities exchange or any broker or dealer, directly or indirectly, to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer —
>
> > (1) on any security (other than an exempted security), in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System shall prescribe under subsections (a) and (b) of this section;
>
> * * * *
>
> (f)(1) It is unlawful for any United States person, or any foreign person controlled by a United States person or acting on behalf of or in conjunction with such person, to obtain, receive, or enjoy the beneficial use of a loan or other extension of credit from any lender . . . for the purpose of (A) purchasing or carrying United States securities, . . . if, under this section or rules and regulations prescribed thereunder, the loan or other credit transaction is prohibited. . . .